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Economic reforms and its impact on the insurance industry in India

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Abstract
Economic reform usually refers to deregulation, or at times to reduction in the size of the government, to remove distortions caused by regulations or the presence of the government. The process of economic reforms was born out of the crisis in the Indian economy which occurred in 1991. This mis-happening compelled the government to adopt a new path-breaking economic policy under which a series of economic reform measures were undertaken not only with the objective to deal with the crisis but also to take the economy on a high growth path. Liberalization and deregulation seek to improve economic welfare by bringing more efficient allocation of resources in the long run. As a consequence, dozens of countries have deregulated and liberalized their insurance markets. Insurance sector in India has also gone through the process of reforms following the recommendations of Malhotra Committee's report submitted in 1994. The insurance industry in India has passed through a period of structural changes under the combined impact of financial sector reforms in general and insurance sector in particular. With the liberalization of insurance sector, the paradigm for Indian insurance industry has witnessed a sea change during the last decade. In this paper an attempt has been made to analyze the overall performance of the insurance industry in India. The results show that there has been a tremendous improvement in the overall performance of the insurance sector in India, particularly in terms of insurance density and penetration.

Keywords: Economic Reforms, Insurance Industry, deregulation.

1. Introduction

In July 1999, the Indian economy had taken certain macro-economic reforms involving stabilization and structural reforms and improve its Balance of Payments (BOP) position. The new economic policy introduced changes in several areas, including insurance. The salient features of the policy also known as "LPG" were:

(a) Liberalization (internal/external)
(b) Privatization
(c) Globalization.

The liberalization of the Indian insurance sector has resulted in a number of insurance companies (both - private as well as foreign) entering the market. This has led to an increase in the available choices not only in terms of service providers but also in terms of products for customers.

In the process of the insurance sector reforms, the legislation of IRDA Bill 1999, marked a definite point in the move towards privatization of the India's insurance sector. This comprehensive bill allowed the entry of private companies in the sector in both – life and non-life sector, but a single company cannot transact business in both.

Globalization implies integration of the economy of the country with the rest of the world economy and opening up of the economy for FDI. Following the privatization of the insurance sector, the global enterprises soon entered the market with a FDI limit of 26%.

2. Objective of the Study

- The study is an attempt to examine the performance of Insurance industry in India in terms of insurance penetration and density, particularly after the liberalization of the insurance sector.
- An attempt has also been made to make an appraisal of the study.
- The study attempts to throw some light on The Insurance (Laws) Amendment Act 2015.

3. Review of Literature

The insurance sector is sine-quo-non for development and economic growth of any economy and it has been recognized for many years. The significance of insurance was also acknowledged in the first conference of United Nations Conference on Trade and Development (UNCTAD) in 1964 by stating that "a sound national insurance and reinsurance market is an essential characteristic of economic growth." [1]

Ranade Ajit and Rajeev Ahuja (1990) in their study identified the emerging strategies in the light of liberalization and private sector entry into insurance. They justified the need for private sector entry on the basis of enhancing the efficiency of operations, achieving a greater density and penetration of life insurance in the country; and for a greater mobilization of long term savings for long gestation infrastructure projects. They pointed out that LIC with its 40 years of experience and wide reach, was in an advantageous position. They also pointed out the need to handle strategic issues carefully. Accordingly, LIC should adopt a liberalized scenario such as changing demography and demand for pensions, demand for a wider variety of products, and having greater freedom in its investments [2].

Pant Niranjan (1999) addressed the need for a more cogent legislation than the Insurance Regulation Development Bill 1999. He viewed that the liberalization of the insurance sector in India will see the increasing involvement of the large and powerful insurance companies of the world in the Indian insurance industry. It was therefore essential to have the support of a stronger regulation to turn this involvement into a positive factor for the growth of the Indian insurance sector in particular and the Indian economy in general [3].

Rao Tripathi (2000) in his paper maintained that the issue of privatization and foreign participation must be approached cautiously with a 'step-by-step approach' and should be proceeded by micro economic institutional and legal reforms. According to him, the macro economic implications of privatization and foreign participation in the insurance sector, specially the life insurance sector, are far-reaching. The life insurance industry was co-terminus with the LIFE INSURANCE CORPORTION OF INDIA (LIC) and was dominant in two respects: pooling and redistributing risks across millions of policyholders and performing financial intermediation [4].

Shrivastava and Shrivastava (2002) hold the view that there is dearth of material inter linkage between economic development on one hand and insurance services on the other, whereas role played by other services like banking, transport, communication, public administration, defense etc. in accelerating the national income of an economy has been properly highlighted [5].

Ahuja Rajeev (2004) appraised the development record of Indian insurance industry in the wake of first four years of liberalization. He however, pointed out four areas in which the insurance regulator needs to quickly move forward namely pension and health insurance, phasing-off tariff, strengthening of self-regulation and reviewing of capital requirement. According to him, the success of the competition in the financial sector ultimately depends upon the efficiency of regulation. So, constant reviewing and fine tuning of the rules by the regulator was also suggested to keep pace with the development in the markets [6]

4. Methodology of the Study

The study is analytical and descriptive in nature. The whole content is divided into two parts with respect to insurance density and insurance penetration, particularly after India's new economic policy of 1991. The period of the study pertains from 2001-2013. The study is based on secondary data, which have been collected from IRDA annual report. The data is related to insurance density and insurance penetration in India. The data has been presented in tables and charts. With the help of excel tools and graphical analysis, the researchers have tried to show the trend and progress of the insurance industry, particularly in terms of insurance density and penetration.

5. Insurance Sector in India

The insurance industry till August 2000 had only two nationalized players – Life Insurance Corporation of India (LIC) and General Insurance Corporation of India (GIC) and its four subsidiaries. These two players had a sort of monopolistic control over the market. Though these companies did a commendable job in terms of high growth in volume of business and reach; however, they failed to be consumer-oriented, unwilling to upgrade technology and technical skills and adopt modern practices and therefore, were inefficient in operations. The growth in volume was mainly driven by income tax considerations and hence, a major section of the vast rural area was untapped. With a population of more than one billion and savings rate of around 24% India had a vast untapped market. And at the same time, the foreign insurance companies' pressure to open up the Indian insurance sector was high.

Therefore, in 1993, a committee was set up under the chairmanship of R.N. Malhotra to evaluate the Indian Insurance Industry and recommend its further direction. The committee submitted its report in 1994 and its major recommendations included:

- Government to bring down its stake in insurance companies to 50%
- Private companies with a minimum paid-up capital of Rs.100 crore allowed to enter the industry.
- No single company should be allowed to transact business in both – life and general insurance.
- Foreign companies may be allowed to enter the industry in collaboration with domestic companies, etc.

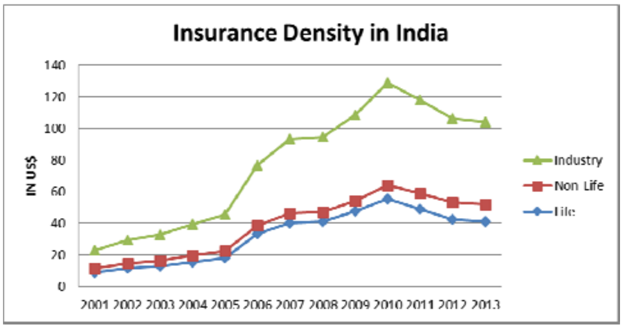
Recognizing the global trend of market driven and competitive industry and the recommendations of the Malhotra Committee, the insurance sector of India was opened up in August 2000. The Insurance Regulatory and Development Authority (IRDA) was constituted in April 2000 under the IRDA Act 1999 and it is vested with the power to carry out the reforms in this sector, regulate and develop the insurance and reinsurance business. The Reserve Bank of India had also given NBFCs permission to take up insurance agency business on a fee basis and without risk participation. The Insurance (Amendment) Act, 2002, had allowed cooperative societies to carry on insurance business with a view to enhancing coverage in rural areas.

The measure of insurance density and penetration reflects the level of development of insurance sector in a country. While insurance penetration is measured as a percentage of insurance premium to GDP, the insurance density is calculated as the ratio of premium to total population (per capita premium) [7]. In India, in the pre reform period, the insurance density as well as the insurance penetration was too low which seemed to improve in the post reform period.

Table 1: Insurance Density in India (2001-2013)

Year	Life (USD)	Non-Life (USD)	Industry (USD)
2001	9.1	2.4	11.5
2002	11.7	3.0	14.7
2003	12.9	3.5	16.4
2004	15.7	4.0	19.7
2005	18.3	4.4	22.7
2006	33.2	5.2	38.4
2007	40.4	6.2	46.6
2008	41.2	6.2	47.4
2009	47.7	6.7	54.3
2010	55.7	8.7	64.4
2011	49.0	10.0	59.0
2012	42.7	10.5	53.2
2013	41.0	11.0	52.0

Source: *IRDA Annual Report 2013-14*



Compiled by Researcher

**Insurance density is measured as ratio of premium (in USD) to total population.*

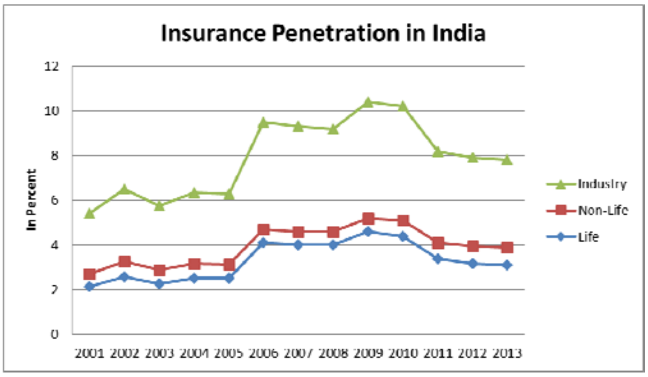
Fig 1

Table 2: Insurance Penetration in India (2001-2013)

Year	Life (Percentage)	Non-Life (Percentage)	Industry (Percentage)
2001	2.15	0.56	2.71
2002	2.59	0.67	3.26
2003	2.26	0.62	2.88
2004	2.53	0.64	3.17
2005	2.53	0.61	3.14
2006	4.10	0.60	4.80
2007	4.00	0.60	4.70
2008	4.00	0.60	4.60
2009	4.60	0.60	5.20
2010	4.40	0.71	5.10
2011	3.40	0.70	4.10
2012	3.17	0.78	3.96
2013	3.10	0.80	3.90

Source: *IRDA Annual Report 2013-14*

**The data of insurance penetration is available with rounding off to one digit after decimal from after 2006.*



Compiled by Researcher

**Insurance penetration is measured as ratio of premium (in USD) to GDP (in USD)*

Fig 2

As seen from the above table and graph, the density of life insurance business had gone up from USD 9.1 in 2001 to the peak at USD 55.7 in 2010. During 2013, the level of life insurance density was only USD 41. During the first decade of insurance sector liberalization, the sector has reported a consistent increase in insurance penetration from 2.71 percent in 2001 to 5.20 percent in 2009. However, since then the level of penetration has been declining reaching a level of 3.9 percent in 2013. A similar type of an increasing trend was seen in the level of insurance density which reached the maximum of USD 64.4 in 2010 as against of USD 11.5 in 2001.

Overall the last 10 years of insurance sector liberalization, the penetration of non-life insurance sector in the country remained steady in the range of 0.5 to 0.8 percent. However, its density has gone up from USD 2.4 in 2001 to USD 11.0 in 2013. The table clearly depicts that in the post reform period with the entry of private and foreign players in the sector, the insurance penetration as well as insurance density has improved.

6. Appraisal of Indian Insurance Market

One of the parameters to measure the performance of the insurance sector in India is the number of registered companies as insurers in India. There were 53 insurance companies operating business in India at the end of March 2014, out of which 24 are in the life insurance sector and 28 in the non-life sector. In addition to this, General Insurance Corporation (GIC) is the sole national reinsurer. Out of 53 companies that are operating in India, 8 are in the public sector, with two specialized insurers, namely; ECGC and AIC and one in life insurance sector namely; Life Insurance Corporation of India (LIC) and four in the non-life insurance sector and one in the reinsurance business i.e. GIC. The remaining forty five companies operating in the insurance sector in India are in the private sector.

Table 3: Registered Insurers in India (as on 30th September 2014)

Type of Business	Public Sector	Private Sector	Total
Life Insurance	1	23	24
Non-Life Insurance	6*	22**	28
Reinsurance	1	0	1
Total	8	45	53

**Includes specialized Insurance Companies-ECGC and AIC*

***Includes five Standard Health Insurance Companies- Star Health and Allied Insurance Co., Apollo Munich Health Insurance Co., Max Bupa Health Insurance Co., Religare Health Insurance Co., and Cigma TTK Health Insurance Co.*

Source: IRDA Annual Report 2013-14

7. The Insurance (Laws) Amendment Act (2015)

The recent regulatory reforms in the insurance industry can be divided into two phases- In Phase I of the reforms the IRDA Bill was presented before the Parliament in 1999 for its approval. In the Phase II of the reforms, there was an introduction of Insurance Laws (Amendment) Act 2008 in the Parliament. This proposal focused on the FDI cap hike in the insurance sector but was rejected by the then Government in May 2012. Again in the winter session of the Parliament in October 2013, the Bill was presented but failed to push up the reform process. However, Modi led NDA Govt. came into power on 16 May 2014 and the Finance Minister, Mr. Arun Jaitley, announced in his first Union Budget speech on 10 July 2014, to increase the FDI limit upto 49% from 26%, with full Indian management and control through Foreign Investment Promotion Board (FIPB). And finally on 26

December 2014, the Government passed the Insurance Laws (Amendment) Act 2015.

The Insurance (Laws) Amendment Act (2015) is a game changer for the insurance industry. It is a major step towards the deepening of economic reform process in insurance sector. With the FDI limit hike from 26% to 49% it will possibly speed up the ongoing reform process in Indian economy and can take the Indian economy into new heights. One of the notable features of this amended Act of 2015 was that the subscribers of Employee's Provident Fund (EPF) will now have choice to opt for New Pension Scheme (NPS) of the Government of India and also the workers covered under the Employee's State Insurance will have the option to choose Health Insurance products organized by the IRDA. If the social security schemes of the Government of India including the state government and the insurance schemes issued by the IRDAI come together through a proper mechanism; would help to bring into reality, "MAKE IN INDIA" the dream of our PM Narendra Modi, through skilled labor force and establishing India as a focus of business both- national and international level.

Some questions have also been raised that the insurance sector will not reap benefits from the FDI increase. There are leaders in the industry who all already well-established and they do not require additional capital. But at the same time there are also companies such that they do not have enough capital to diversify and therefore are not doing well. These are the ones that are going to benefit by the FDI reforms introduced in the sector.

If the private sector is allowed to bring in 49% equity; according to an estimate; this can probably bring inRs.50000 crore in the industry. And it is believed that this will enable the insurers to set up offices in the rural areas and thus, enable the general public to buy more policies. Therefore, it can also be said that in a way these reforms are going to make the industry more transparent and consumer-friendly, which clearly means that they are going to benefit not only the insurers but are also going to be beneficial for the customers (insured) too.

Table 4: Estimated Additional Capital Flows to the Sector due to FDI Limit Hike

Private Players	Equity Capital (Rs Crore)		
	FY 14	**Scenario II**	**Scenario I**
Life	25839	11627	6537
Non-Life	6556	2802	1718
Specialised Health	1684	758	472
Total Equity Capital	33749	15187 ($2.5 bn*)	8727

Source: *IRDA Journal March 2015 & computed; *assuming $1=Rs62*

It is felt by experts that the Government should favour the Scenario II, i.e., to issue of fresh shares for extra foreign investments, rather than sale of shares by domestic promoters. In this scenario, our estimates show that insurance companies may receive around `Rs.15187 crore ($2.5billion, assuming $1 is = Rs.62) of additional foreign investment in the way of hike in FDI limit. But, if Government will favour Scenario I in the insurance companies, it is estimated that an additional investments of Rs.8727 crore may flow to the industry, through foreign investments. However, the objective of hike in FDI limit may not be achieved, as the capital base will remain same and the insurers will not be able to expand their footprint to achieve the national agenda of financial inclusion.

In addition to this, the Finance Minister also had announced many schemes in his Union Budget speech 2015-16, which would lead to increase the insurance penetration in the country and especially in the health insurance segments. Some of them are:

- In line with Pradhan Mantri Jan Dhan Yojana (PMJDY), another scheme named Pradhan Mantri Suraksha Bima Yojana (PMSBY) was also announced that would cover accidental death risk of Rs.2 lakh for a premium of only Rs.12 per year, i.e. 1 per month.
- Pradhan Mantri Jeevan Bima Yojana (PMJBY), a social security scheme was also announced that would cover both – natural and accidental death risk of Rs. 2 lakh. The premium would be Rs.330 per year or less than a rupee per day, for the age group of 18-50 years.
- Government has proposed to increase the health insurance deduction limit under Section 80D to Rs.25000 from Rs.15000.

8. Conclusion

The insurance industry in India has passed through a period of structural changes under the combined impact of financial sector reforms in general and insurance sector in particular. With the liberalization of insurance sector, the paradigm for Indian insurance industry has witnessed a sea change during the last decade. FDI was much needed in the Indian insurance industry as it brought the requisite growth capital from foreign promoters, better insurance business practices not available in the country and of course the new type of international exposure from foreign players and thus helped in deepening the penetration of insurance products in the Indian rural markets, where the penetration level was too low. The privatization of the sector has also contributed in a great way by increasing the insurance density and also penetration in both – life and non-life segments. Concludingly, the study reveals that the economic reforms in the sector have led to the overall improvement in the performance of the insurance industry as a whole.

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